



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	2/23/06	Bill No:	AB 2502
Tax:	Sales and Use Special Taxes and Fees	Author:	Arambula
Related Bills:			

BILL SUMMARY

This bill would allow a taxpayer that employs less than 50 people whose credit under specified provisions of the Personal Income Tax Law and the Corporation Tax Law exceeds its "net tax" to apply that credit to tax liabilities incurred under specified tax programs administered by the Board of Equalization (Board).

The bill would require the Board to report to the Legislature by October 1, 2009, on the use of the tax credits transferred pursuant to this bill.

ANALYSIS

Current Law

Under the Personal Income Tax Law and the Corporation Tax Law, a variety of credits are allowed against the taxes imposed under those laws. Under these laws, when the credits exceed the net tax, the excess may not be claimed as a refund, but rather, may be carried over to succeeding tax returns until that credit is exhausted.

Under various parts of the Revenue and Taxation Code, the Board is charged with the administration of a variety of taxes and fees, including sales and use tax, Bradley-Burns uniform local sales and use tax, transactions and use tax, alcoholic beverage tax, cigarette and tobacco products tax, motor vehicle fuel tax, aircraft jet fuel tax, diesel fuel tax, interstate user (IFTA) tax, emergency telephone users surcharge, energy resources surcharge, tax on insurers (in part), integrated waste management fee, natural gas surcharge, childhood lead poisoning prevention fee, oil spill response, prevention, and administration fee, underground storage tank maintenance fee, use fuel tax, hazardous substances tax, California tire fee, occupational lead poisoning prevention fee, marine invasive species fee, electronic waste recycling fee, water rights fee, timber yield tax, and private railroad car tax.

The revenue derived from the imposition of the majority of the above taxes and fees is transferred to either special funds or local government or is used to fund various programs as provided in law. Those tax programs for which revenues are transferred to the General Fund, in whole or in part, include:

- Sales and use tax
- Private railroad car tax
- Cigarette tax
- Alcoholic beverage tax
- Tax on insurers

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Proposed Law

This bill would add and repeal Section 15616.5 of the Government Code to require the Board to report to the Legislature by October 1, 2009, on the use of the tax credits transferred pursuant to this bill.

This bill would also amend Sections 17052.12, 17053.24, 17053.46, 17053.47, 17053.70, and 17053.74 of the Personal Income Tax Law and Sections 23609, 23612.2, 23622.7, 23622.8, 23634, and 23646 of the Corporation Tax Law to allow a taxpayer whose credit under these provisions exceeds the net tax, as defined, to transfer the credit and apply the credit to a tax liability under the following conditions:

- The taxpayer is a person or entity that employs less than 50 people.
- The tax liability the transferred credit is applied to is incurred under:
 - 1) The Sales and Use Tax Law
 - 2) The Motor Vehicle Fuel Tax
 - 3) The Use Fuel Tax Law
 - 4) The Alcoholic Beverage Tax Law
 - 5) The Timber Yield Tax
 - 6) The Hazardous Substances Tax
 - 7) The Diesel Fuel Tax Law
- The revenues derived from the imposition of the tax are allocated to the General Fund and are not allocated to a special fund.
- The taxpayer who applies for a tax credit transfer shall submit the application for the transfer in a form as prescribed by the Board.

The bill specifies that the Board may promulgate rules and regulations necessary to establish procedures, processes, and requirements to implement these provisions and that nothing in these provisions limit the authority of the Board or the Franchise Tax Board to audit a taxpayer who has transferred the credit pursuant to this measure.

The provisions of this bill would become effective for each taxable year beginning on or after January 1, 2007.

Background

Other measures have been considered in the past that have proposed to authorize taxpayers with credits exceeding their "net tax" under the provisions of the Personal Income Tax Law and the Corporation Tax Law to apply to the Board to receive the full benefit of the credits. These include:

SB 1045 (Vasconcellos, 2001-02), which would have provided a mechanism for computer manufacturers who were currently ineligible to claim the manufacturer's income tax credit under the Personal Income Tax Law or the Corporation Tax Law to file a claim for refund with the Board for the entire six percent income tax credit.

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SB 855 (McPherson, 1997-98), which would have provided a mechanism for firms engaged in biotechnology research and development activities who were ineligible to claim the manufacturer's income tax credit under the Personal Income Tax Law or the Corporation Tax Law to file a claim for refund with the Board for the entire six percent income tax credit.

AB 2640 (Morrissey, 1995-96), which would have provided a mechanism for certain businesses who are operating under a net loss situation and currently ineligible to claim the manufacturer's income tax credit under the Personal Income Tax Law or the Corporation Tax Law to file a claim for refund with the Board for the entire six percent income tax credit on their manufacturing equipment purchases.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author. Its purpose is to enable small businesses to realize the full benefit of the tax incentives provided in law by allowing the transfer of the existing credit or credits toward the payment of other taxes owed to the state.
2. **Not all tax programs are General Fund revenue sources.** The bill specifies that one of the conditions necessary to transfer the income tax credit to the Board for application to a tax liability is that the revenues derived from the imposition of the tax are allocated to the General Fund and are not allocated to a special fund. Many of the taxes referenced in the bill to which the tax liability could be transferred, however, are not General Fund revenue sources. In fact, of the tax programs referenced in the bill, only revenues derived under the Sales and Use Tax Law (at the 5.25 percent rate) and the Alcoholic Beverage Tax Law are actually General Fund revenue sources. Consequently, the bill should be amended to strike the remaining referenced tax programs, and perhaps, include the other General Fund tax programs consistent with the author's intent.
3. **Shouldn't the FTB administer a refund program?** The Board would be required to approve credits and apply those credits to existing tax liabilities based on provisions administered by the FTB. Since the FTB has the expertise in administering the Personal Income Tax Law and the Corporation Tax Law, it appears more appropriate to retain administration of these credits within that agency and require the FTB to initiate a refund when the credit exceeds the "net tax." Not only would this provide a more efficient program, but it would allow all qualifying small businesses to benefit from the tax incentives created by the Legislature – not just the small businesses that have tax liabilities with the Board.
4. **If enacted, this bill could have some unintended, undesirable consequences.** For example, the bill could provide an incentive for businesses to postpone remitting tax with their quarterly sales and use tax returns in anticipation of applying a credit from an upcoming annual income tax return. Alternatively, a business might over pay its sales and use tax liability in order to apply a credit from an income tax return, and then file a claim for refund for the excess sales and use tax paid. In addition, the small businesses that do not have a tax liability with the Board might be encouraged to purchase equipment from out-of-state businesses

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in order to apply their income tax credits to use tax liabilities. Alternatively, these businesses could be encouraged to deduct the sales tax on an invoice they receive from a California merchant in an attempt to gain credits through any available means.

5. **The condition requiring that the taxpayer employ less than 50 people is ambiguous.** The persons or entities qualifying for the transfer provisions must only employ less than 50 people. Without more specificity regarding this employment condition, some issues could arise. For example, would a taxpayer qualify if he or she employed 25 part time personnel, and 26 full-time personnel? What if the taxpayer employed 70 employees during half of the year, and 30 the other half? Does the employment number only pertain to the actual number of employees employed during the return period in which the taxpayer claimed the credit on his or her income tax return? This should be clarified consistent with the author's intent.
6. **What happens to unused credits?** The bill is silent with respect to situations in which the excess credit is transferred and applied to an existing tax liability, and some unused credit is still available. Would the taxpayer be entitled to a refund, or, would the taxpayer be required to file another application when a subsequent tax liability arises? Would the taxpayer be able to transfer the credit back to the Franchise Tax Board and carryover the unused credit to the succeeding income tax return filed? This should be addressed consistent with the author's intent.
7. **Bill should clarify the appropriate statute of limitations.** Under the personal income and corporation tax laws, the statute of limitations is generally four years. Under the tax programs administered by the Board, the statute of limitations is generally three years. Once a credit is transferred and applied to a tax liability, there may be a question as to which statute is controlling for purposes of refunding overpayments or making assessments in future years.
8. **Other clarifying language is recommended.** The bill provides that the credit that exceeds the "net tax" may be transferred and applied to specified "tax liabilities." Since, in addition to the tax, liabilities under the various tax programs often include delinquency charges, such as interest and penalties, it is recommended that, instead of applying the credit to a "tax liability," the bill specify that the credit be applied to a "liability." In that way, the excess credit could be applied not only to the tax liability, but also, any interest or penalty that may be due.

COST ESTIMATE

Administrative costs would be incurred in developing the application required by this measure, reviewing the application, and making the transfers. Also, depending on the number of applications, some programming costs could be incurred to apply the credit to the 5.25 percent portion of the sales and use tax rate. However, it is difficult to determine how many taxpayers would apply to the Board for the transfer. This difficulty is exacerbated by the fact that the number of common taxpayers that file returns upon which the specified tax credits are claimed and that incur tax liabilities with the Board is unknown.

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REVENUE ESTIMATE

Since these tax credits are administered by the Franchise Tax Board, the Board does not maintain any data that would be applicable to determine the impact on General Fund revenues. Consequently, we will defer to the Franchise Tax Board for providing information on the tax credits described in the bill.

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